

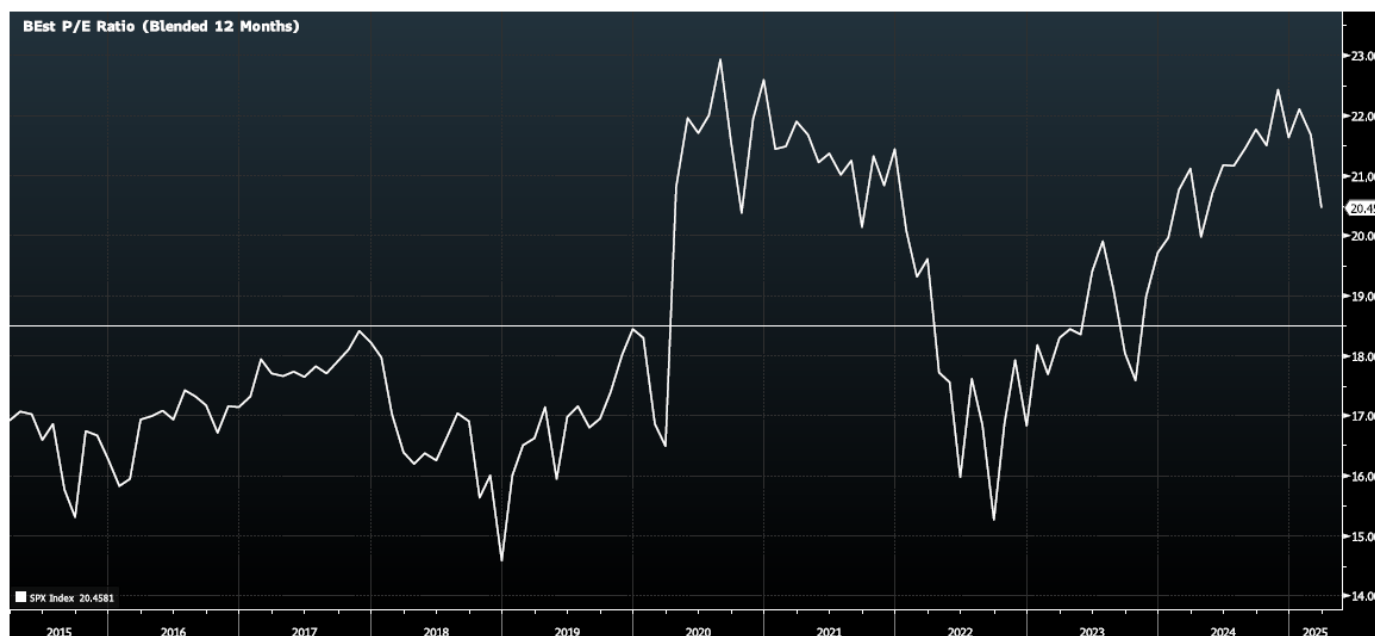
February 2025 Market Commentary

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Growing unease about rapidly changing tariff announcements, DOGE-driven layoffs and budget cuts, and general policy uncertainty have driven a swift market reset and weighed on sentiment over the last few weeks. Equity valuations continued to climb after the election as investors were optimistic about continued economic growth driven by deregulation, tax cuts, and a generally more friendly backdrop for business. Yet, there was little room for error, with the S&P 500 trading at an elevated Price/Earnings ratio of over 22x at the recent market peak in the middle of February. Once the policy rollout looked less pro-growth-oriented than anticipated, valuations reset lower. Over the last few weeks, the frantic pace of executive orders, almost 90 in the first 50 days in office, the on again off again, but mostly on-again tariff announcements, and federal worker layoffs and budget cuts have been whipsawing markets and causing investors to throw up their hands. Last week, the S&P 500 and NASDAQ entered correction territory, down more than 10% from their highs. Year-to-date, that leaves the S&P 500 off roughly 4% and the NASDAQ lower by about 8%.

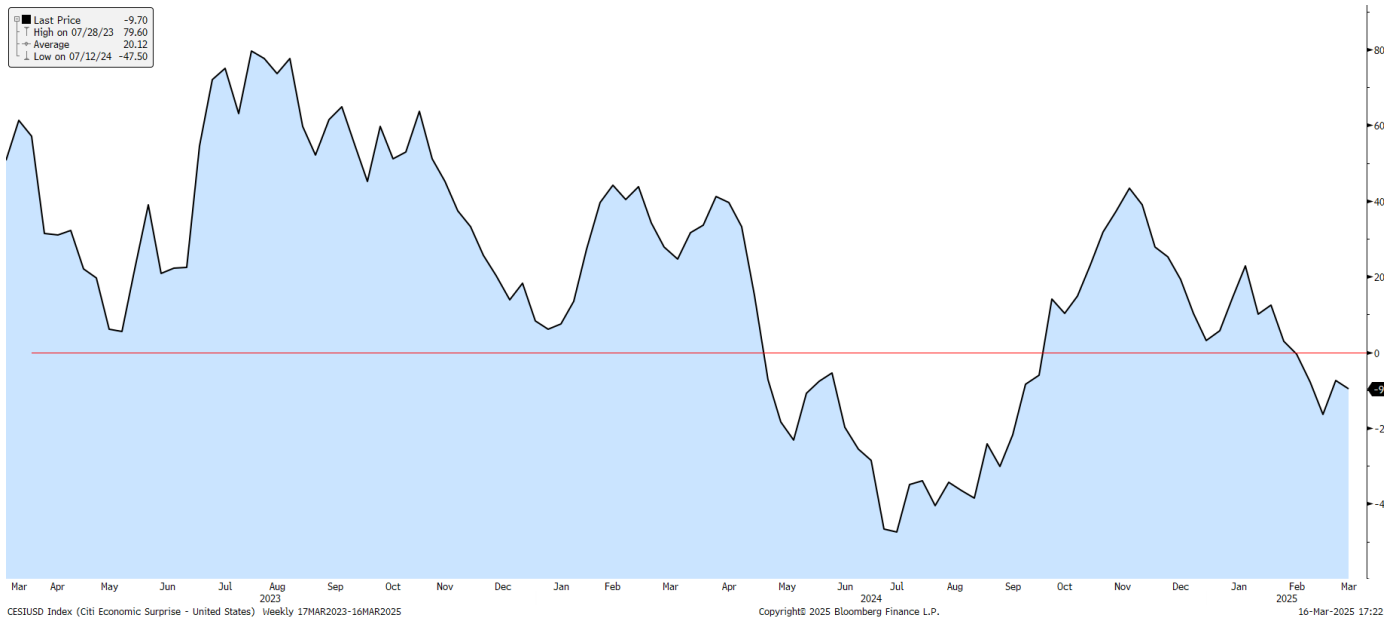
Forward S&P 500 P/E has Declined to a More Reasonable ~20X But Remains Above 10-Year Avg. of ~18.5X



Source: Bloomberg

The pace and disjointed rollout of the trade and cost-cutting moves make the potential impacts tough to assess, but the downside risks to economic growth have more than likely increased. Stalling growth and an increasing chance of a recession are now likely the biggest risks for the markets going forward. The Citi Economic Surprise Index has turned negative as economic data has been coming in weaker than expected, and as economic uncertainty has only increased, we expect lower readings ahead. Moreover, the Atlanta Fed's GDPNow model estimates annualized economic growth in the first quarter of -2.8%. However, this is likely skewed by a surge in imports ahead of potential tariffs, but directionally, the number does not bode well.

Citi Economic Surprise Index Indicates Economic Data is Missing Expectations

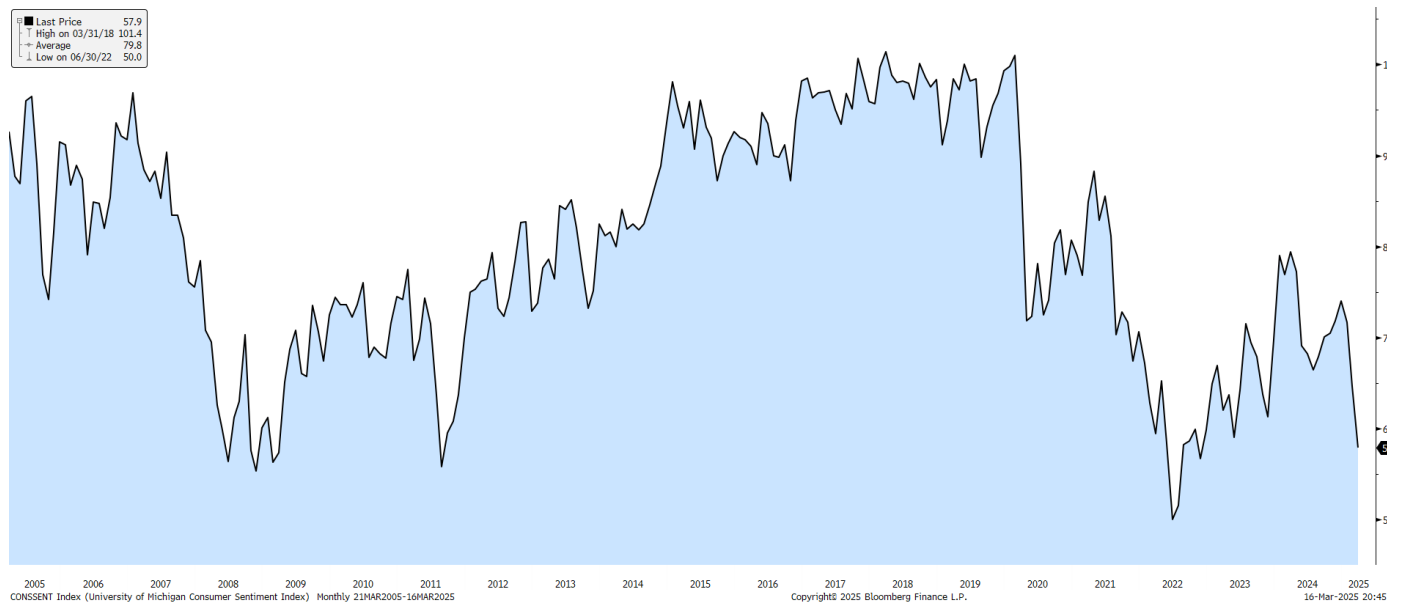


Source: Bloomberg

The University of Michigan Consumer Sentiment data plummeted to 57.9 in March, the lowest reading since November 2022, and down 22% from December. Dour sentiment about the economy can cause consumers to cut back on spending, and this appears to be at least happening on the margins, given a string of negative commentary from retailers and consumer-oriented companies over the last few weeks. According to the report, consumer expectations “deteriorated across multiple facets of the economy, including personal finances, labor markets, inflation, business conditions, and stock markets,” primarily due to “uncertainty around policy and other economic factors.” The sentiment data has primarily been split among political party lines, with Democrats feeling much worse since the election. However, the latest data also shows Republican sentiment is starting to roll over – further weakening could

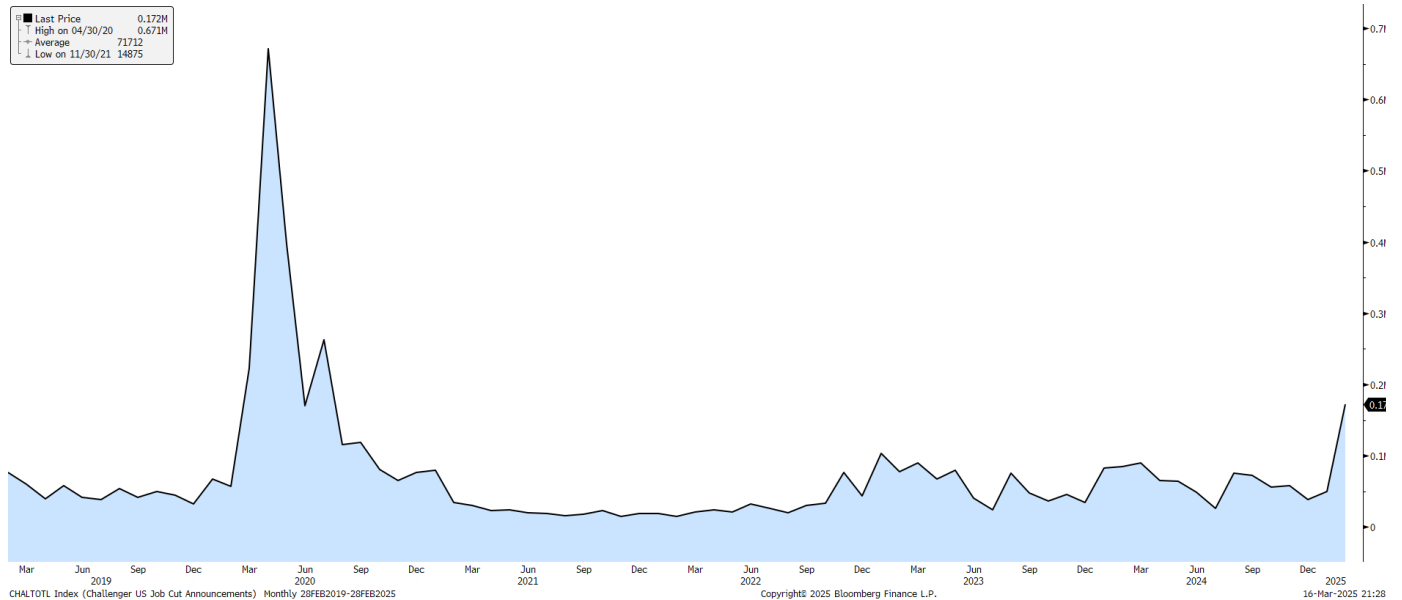
give the administration pause and cause them to rethink their recent rhetoric, indicating that they are comfortable with “a period of transition”.

University of Michigan Consumer Sentiment Data Rapidly Deteriorating



Source: Bloomberg

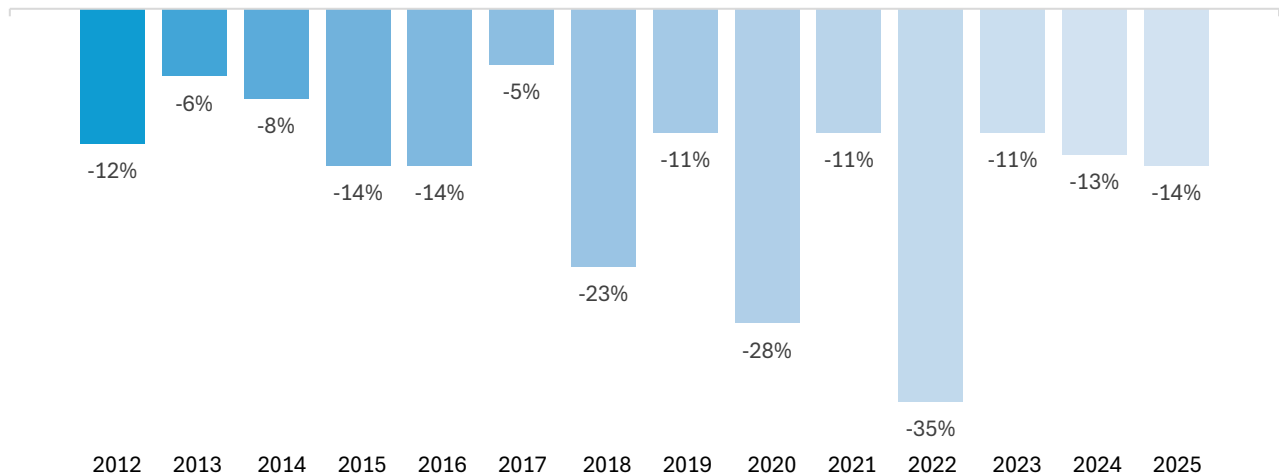
The labor market has moderated over the last few months but remains in decent shape, with the economy adding 151k jobs in February and the unemployment rate at a historically low 4.1%. Yet, with DOGE-induced firings of federal workers and companies potentially reluctant to add workers among the uncertainty, we are watching for signs of deterioration. According to Challenger, Gray & Christmas, job cuts surged to the highest level since July 2020 in February, with government jobs accounting for the bulk of the layoffs.

Challenger Gray US Job Cut Announcements

Source: Bloomberg

Stocks and investor sentiment now appear to be discounting worsening conditions, but if the economy avoids a recession and/or if there is some relief on the policy front, both of which seem possible, equity markets are likely to recover over the medium term, albeit with more volatility in the short run. The speed of the pullback has been stomach-turning, with the S&P 500 falling 10% in 20 days, the 5th fastest pullback in history. It is also the first time the index has been down more than 10% since 2022, an unusually long stretch. Still, the correction is on par with the median historical intra-year decline of -10.5% for the S&P 500 and -14.8% for the NASDAQ.

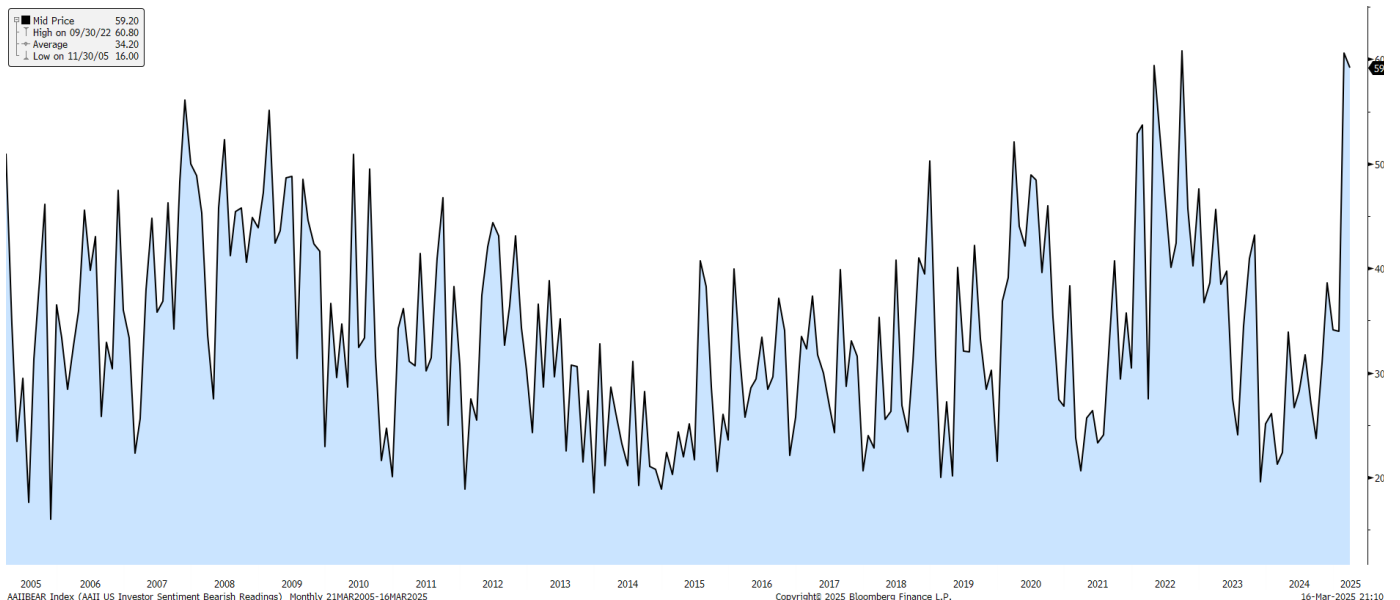
NASDAQ Largest Intra-Year Drawdowns



Source: Bloomberg

At this point, investor sentiment appears to be washed out. The latest American Association of Individual Investors (AAII) survey indicated bearish sentiment came in at just over 60%, marking the third week in a row that bearish responses have come in above 55%, which previously only happened once, right before the market bottom in March 2009.

AAII Sentiment Data Show Extreme Bearish Sentiment – Typically a Contrarian Indicator



Source: Bloomberg

Meanwhile, there is not the same amount of panic in the credit markets. Credit spreads have widened from historically tight levels, but they are still not raising any alarm bells suggesting an imminent recession or worse. Accordingly, the current bout of selling seems mostly about a reset of valuation levels to account for rising policy uncertainty and an associated downtick in growth versus something more dire. We will continue to monitor the labor market for any signs of weakening, which we see as a key risk. For now, the selloff appears to have more to do with the macro backdrop, and investors appear braced for things to get worse. Accordingly, if there is a hint that a few things might start moving in the right direction, which could easily include a rollback of some of the policy initiatives, including tariffs (immigration has slowed dramatically at the southern border and the most recent trade talks with Canada seem to be on a better track), a pickup in housing activity and other interest rate sensitive areas as the 10-year US Treasury yield is down roughly ½ percent from its January peak, a more dovish Federal Reserve posture when they meet next week, or a breakthrough in Ukraine peace talks, the equity markets could be poised for a healthy rebound over the next few months. Yet even if a broad-based rally does not occur, we will continue to adapt to the rapidly shifting backdrop with a focus on risk management while looking for long-term attractive fundamental opportunities amidst the dislocations that will invariably occur.

As always, we would enjoy hearing from you. Please reach out with any comments or questions.

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